MULTIMEDIA UNIVERSITY

STUDENT IDENTIFICATION NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 1, 2017/2018

BFM1014 – FUNDAMENTALS OF FINANCE

(All sections / Groups)

26 OCTOBER 2017
2.30 PM – 4.30 PM
(2 Hours)

INSTRUCTIONS TO STUDENT

1. This Question paper consists of 5 pages with 4 Questions only.

2. Attempt **ALL** questions. All questions carry equal marks and the distribution of the marks for each question is given.

3. Please write all your answers in the Answer Booklet provided.

Answer ALL FOUR (4) questions. All questions carry equal marks and the distribution of the marks for each question is given.

QUESTION 1

A. Even though you are not majoring in Banking and Finance program, it is important to have the knowledge of finance. Somehow, you have to make responsible financial decisions that will be very important to you personally. Briefly explain **THREE (3)** examples of the financial decisions.

(6 marks)

B. Olivia and her spouse have saved RM 4,500 for a 12-day cruise vacation in Europe. They plan to go there in three years from now. They need RM 5,000 for a "nice" cabin or RM 6,000 for a "luxury" cabin. The cabin prices are expected to remain constant for the next three years.

i. If Olivia expects to earn 6% per year on her investments, will their savings be enough to afford the "nice" cabin in three years? Can they afford the luxury cabin? Why or why not?

(7 marks)

ii. If Olivia really wants to stay in the luxury cabin, what is the interest rate that she needs to earn on the investment?

(5 marks)

C. The furniture store offers you no-money-down on a new set of living room furniture. Further, you may pay for the furniture in three equal annual end-of-the-year payments of RM 1,000 each with the first payment to be made one year from today. If the discount rate is 6%, what is the present value of the furniture payments? If the discount rate increase to 9%, what is the present value of the payments?

(7 marks)

[TOTAL 25 MARKS]

Continued...

QUESTION 2

A. Progressive Plastics Inc. issued 30-year 7% annual coupon bonds five years ago. Currently, the yield to maturity is 9.65% on these RM 1,000 par value bonds. What is the interest payment of the bond? What is the current price per bond? What is the classification of the bond?

(10 marks)

B. Fancy costumes is expected to pay the following dividends over the next four years; RM 5, RM 16, RM 21 and RM 2.80. Afterwards, the company pledges to maintain a constants 4% growth rate in dividends, forever. If the required return on the stock is 11%, what is the current share price?

(10 marks)

C. Suppose a company has issued preferred shares and ordinary shares. Both just paid a RM 2 dividend. Briefly explain the difference between the two shares. Justify which share do you think will have a higher price?

(5 marks)

[TOTAL 25 MARKS]

Continued...

QUESTION 3

A. A Pit-stops auto-parts company is deciding whether to sponsor a racing team for a cost of RM 1 million. The sponsorship would last for three years and is expected to receive cash flows of RM 570,000 per year. If the discount rate is 6.9%, what is the net present value (NPV) if it chooses to go ahead with the sponsorship? What is the profitability index for the sponsorship? What is the payback period? Should the company sponsor the team?

(10 marks)

B. Genius Scientific Solutions has RM 12 million of outstanding equity and RM 4 million of bank debt. The bank debt costs 4% per year. The estimated equity beta is 1. If the market risk premium is 8% and the risk-free rate is 4%, compute the weighted average cost of capital (WACC) if the firm's tax rate is 30%.

(10 marks)

C. Briefly define the following terms: regular cash dividend, stock dividend, special dividend, and liquidating dividend. An increase in which of these dividends appears to send the most positive signal to the market? Why?

(5 marks)

[TOTAL 25 MARKS]

Continued...

QUESTION 4

A. What do you understand about working capital management? Briefly explain **TWO (2)** reasons why is it importance for financial managers to have knowledge of working capital management?

(6 marks)

B. Golf Gear Inc. manufactures custom the golf clubs and orders 250,000 graphite shafts per year from its manufacturer. The CEO of Golf Gear wishes to know the optimal Economic Order Quantity (EOQ). The carrying cost is RM 0.45 per shaft per year. The order cost is RM 750 per order. What is the EOQ for Golf Gear? What are the total annual carrying costs? What are the total annual ordering costs? Please round all of your answers to the nearest dollar or unit.

(7 marks)

C. Magical Dancers Company has a cash cycle of 42.5 days, an operating cycle of 62 days, and inventory period of 26 days. The company reported cost of goods sold in the amount of RM 340,000 and credit sales were RM 563,000. What is the company's average balance in account payable and account receivable?

(12 marks)

[TOTAL 25 MARKS]

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APPENDIX

Future Value:

$FV = PV(1 + r)^t$

Annuities

$$PV = PMT\left[\frac{1-\frac{1}{(1+r)^t}}{r}\right]$$

$$FV = PMT\left[\frac{(1+r)^t-1}{r}\right]$$

Perpetuity: $PV = PMT / r$

EAR & APR

$$EAR = \left[1+\frac{APR}{m}\right]^m - 1$$

$$APR = m\left[(1+EAR)^{1/m} - 1\right]$$

Bond Pricing

$$\text{Bond Value} = C\left[\frac{1-\frac{1}{(1+YTM)^t}}{YTM}\right] + \frac{F}{(1+YTM)^t}$$

Stock Value

$$\hat{P}_0 = \sum_{t=1}^{\infty}\frac{D_t}{(1+R)^t}$$

Estimating Dividends

Zero growth: $P_0 = D / R$

Constant Growth Stock: $D_t = D_0(1+g)^t$

Dividend Growth Model:

$$\hat{P}_0 = \frac{D_0(1+g)}{R-g} = \frac{D_1}{R-g}$$

Nonconstant + Constant growth

$$\hat{P}_0 = \frac{D_1}{(1+R)^1} + \frac{D_2}{(1+R)^2} + \frac{D_3}{(1+R)^3} + \ldots + \frac{D_\infty}{(1+R)^\infty}$$

Net Present Value

$$NPV = \sum_{t=0}^{n}\frac{CF_t}{(1+R)^t} - CF_0$$

Cost of equity

$$R_E = R_f + \beta_E(E(R_M) - R_f)$$

WACC

$= E/V \times R_E + P/V \times R_P + D/V \times R_D(1 - T_C)$

Operating cycle

= inventory period + accounts receivable period

Cash Cycle

= Operating Cycle – Accounts payable period

EOQ Model

$$Q^* = \sqrt{\frac{2TF}{CC}}$$

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